



1941

## Economic Conditions Governmental Finance United States Securities

New York, January, 1941

### General Business Conditions

**T**HE old year has closed with industrial operations in this country at the highest rate ever reached, and with a clear prospect that they will move still higher in 1941. Simultaneously, the industries are producing for defense needs, expanding for still greater production, and supplying the increased wants of people whose buying power is rising. Some export and import trades are depressed by war disruptions, but they do not bulk large in the general situation. The outstanding fact is that payrolls are rising, living costs holding steady, and purchasing power spreading around the circle, demonstrating once more that the industries support each other. The increase in income payments has been reflected in active Christmas trade and new highs in automobile sales for this time of year.

The record of 1940 will show that industrial output has exceeded 1939 by 13 per cent and 1929, the previous record year, by 10 per cent. New all-time peaks have been made in production of iron and steel, machine tools, electrical equipment, aircraft, aluminum, cotton and rayon goods, rubber products, chemicals and electric power; and in other cases, where the year as a whole has not fully equalled past records, the current rate is at a new high. Shipbuilding has revived to above 1920 levels. New building is the highest in eleven years, and industrial and engineering contracts are two to three times as large as a year ago.

#### The Prospect for 1941

At New Year's business men are usually asking whether business in the coming months will be good or bad; but this year their own order books, together with the spreading effects of the defense program and British buying, dispel most of the doubts. For the first time since 1929 the question is not how much people will be able to buy, but whether all the demands can be filled. Since June Congress has appropriated nearly \$9,000,000,000 directly for defense, and authorized contracts for another \$3,700,000,000. Contract awards have

totalled around \$10,000,000,000. Total defense disbursements, however, have reached only \$1,700,000,000. The difference is an indication of the volume of work in preparation, to say nothing of British orders and the further huge appropriations which the next Congress seems certain to make.

To increase output further, the industries in many cases will have to expand plants and equipment, do more sub-contracting, train new labor, or raise productivity in other ways. This takes time, and may slow down the pace of the upswing as compared with the past few months. In the Federal Reserve Board's seasonally adjusted index of industrial production, which was 132 (1935-39=100) in November and probably higher in December, a seasonal rise of about 5 per cent in output is allowed for between January and May. The index will advance during that period only if the expected rise is exceeded. Considering its present height, a flattening out for a time, and possibly a moderate decline, would cause no surprise.

However, the steps being taken to increase capacity, and the urgency of the demand, indicate that the ceiling is temporary. In airplanes and motors, tanks, ammunition and ordnance, the armament effort—although the gains in output deserve recognition—is still largely in the stage of construction and machinery installation. Shipbuilding and machine tool facilities are being increased; more steel, aluminum, zinc and tin producing capacity is being prepared; and the electric power industry is likely to spend more on plant and equipment in 1941 than in any year since 1930. As new plants are built, new housing is required. As the plants go into production, employment will spread and buying power for goods of everyday use will increase further, expanding demands on the peacetime industries.

Industrial buyers have been anticipating the upward trend through forward commitments and inventory increases. There are elements of danger in general forward buying,—first, that productive facilities may be unnecessarily overloaded, and second, that buyers may

be caught with excessive stocks. During the past few weeks, however, the markets for industrial raw materials have quieted and the advancing price trend has flattened out. Possibly this is a sign that sober judgment is minimizing fears of inflation and therefore diminishing the danger of over-buying.

Barring unpredictable events, the rising inventories seem to offer no immediate threat. The trouble will come only when stocks cease to turn over normally. For a long time ahead the call for greater production will keep materials moving, while the finished goods that go for defense purposes and aid to Britain will move regularly into consumption without entering normal channels of trade.

#### Sober Sentiments

By the familiar precedents, a business situation and prospect such as described should induce a spirit of optimism, speculative activity and buoyant enterprise. For eleven years the major problem of this country has been to overcome depression and get people back to work; and for the first time in that period the historical upward trend of American business seems to be resumed with a vigor which holds promise that the goal of employment for everyone able to work will be reached.

Nevertheless, the general observation is that sentiment is buoyant only with respect to the volume of business ahead. However welcome the boom will be while it lasts, consideration of its causes, of the uncertainties and difficulties which go with it, of the tax burden and mounting debt, and of the disastrous after-effects which will surely follow unless it is wisely guided, has a sobering effect. It will be a busy year, but not an easy one.

Although the United States is at peace and enjoying good fortune, the tragedy in Europe increasingly affects everyone here. A year ago scarcely anyone foresaw the course that the war would take, only four to six months ahead, and even fewer glimpsed the possibility that war influences would soon control domestic business almost as completely as if we were at war ourselves. The events of last Spring were a shock almost without parallel. Their consequences have dominated political and economic policy from that time, and are far from having run their course. No one can say whether 1941 will bring equivalent shocks, or guess what the effects of war developments may be.

#### War Activity Not Genuine Recovery

It is a misnomer to refer to war-induced activity as a genuine "recovery." Full employment is only one condition of prosperity. Others are that economic activity should be for the purpose of raising living standards, and that it should be self-supporting. Until peace,

order and good faith in all relations are again the normal condition, and until production is devoted to the creation of new wealth and goods that people can use and enjoy, instead of to armament and destruction, there can be no recovery to the full state of prosperity which the productive resources of the world make possible.

Although obscured and temporarily offset by the effects of the defense program, some of the maladjustments which have kept the depression going have not been corrected. Some have been accentuated by the war. Exports of farm products have been sharply reduced and the American Farm Bureau Federation at its annual meeting in December asked for more, not less, government aid. Although our total export trade is larger than before the war, fully two-thirds now goes to the British Empire and consists largely of munitions and war materials. The opportunities for American business in South America are maintained partly by government credits, and the difficult long-term problems remain to be worked out.

To business, armament spending is largely a temporary stimulus; economically it is but pump priming on a greater scale; and it is not productive, but on the contrary is a burden on the productive system. It will undoubtedly show to its credit immense improvements in industrial technique, from which the world in due course will benefit. But in the main it is a blind alley along the road of economic progress, and after the end is reached the retracement may be difficult. It holds incalculable dangers of unbalancing the economic structure and of fiscal instability.

When business men try to plan far ahead these are all considerations of the most practical kind. Even though during 1941 and probably much longer they will remain obscured by the defense activity, they are critical points in every determination of policy, whether by Government, business, or labor.

#### Problems of the Coming Year

The problems of 1941 fall into two parts. The first is to get a job done, namely, to provide all the armament, shipping and supplies that are needed by this country and Great Britain as quickly as possible. The second is to control the effects of the augmented demands so as to restrain inflationary tendencies. Some observers conclude that these problems in fact are identical—that both can be solved by a diversion of production from passenger automobiles, mechanical refrigerators and other consumers' durable goods into planes, guns and tanks, together with appropriate taxation to absorb for defense needs the income which otherwise would have been spent on automobiles and other goods.

This, however, is an over-simplification of the problem. Current comment suggests that the extent to which planes, tanks and guns can be made in plants designed for other purposes, and the readiness with which peacetime plants can be converted, is frequently overestimated. This is one of the factors, foreseen from the beginning, which causes disappointment with defense progress. Mr. Sloan of General Motors in an address within the past month stated that only 10 to 15 per cent of the machinery and equipment of an automobile factory can be used for turning out such products.

Industrialists and officials charged with the defense effort agree that while the peacetime industries should be mobilized to the utmost, the final machine operations and assembly of armaments require, to a considerable extent, plants and machinery built for that purpose. When these plants are ready and tooled up, they must and will draw upon other industries for parts and accessories, either in semi-finished form or ready for final assembly. But the armament plant construction program has not reached that stage. Mr. Knudsen in his speech to the National Association of Manufacturers on December 13 estimated roughly that "we are 20 to 25 per cent tooled up now. \* \* \* I forecast that with your help we could be 80 per cent tooled up by April and the balance by May 31. This is naturally an over-all figure which cannot be applied to specific items but I consider it possible to attain. I ask you to help get it."

#### **Machinery the Key**

The machine tool industry doubled its production in 1940 as compared with 1939, from \$200,000,000 to \$400,000,000; and in 1941 expects to produce \$600,000,000 or more. Mr. Knudsen, while asking for still more, has warmly commended this performance. Increased output is being accomplished by plant expansion, installation of new equipment, sub-contracting, and training large numbers of new men in order to operate equipment as continuously as possible. The National Machine Tool Builders' Association states that nearly half of the nation's machine tool employees today have been trained on the job since September 1939.

Machine tool producers have agreed that their output can be speeded further, but call for a more definite program and scheduling. Their criticisms of the defense effort, and those of others best qualified to judge, concern chiefly the inadequacy of planning and coordination, not only to speed expansion, but to promote sub-contracting and to make the most effective use of existing tools.

Study is under way of plans for a vast joint contribution by the automobile and parts industries, and the tool and diemakers ordinarily employed by them, toward an airplane con-

struction program wholly outside the existing aviation industry. That these plants can make a great contribution to the airplane program in due time, and that their resources should be utilized with all speed, cannot be doubted. A heavy bomber, however, is said to contain 25,000 parts. Many are made of materials which the automotive industry does not even use to any great extent, and by processes and methods wholly foreign to automobile manufacture. Even if the automobile plants within a short time could turn out 24,000 of these parts there would still be no finished bombers until machines to make the other thousand parts and plants for final assembly could be completed. The study being made may evolve a practicable plan, but the question is not one for laymen to judge.

Between the two problems of getting the job done and controlling inflationary forces, there is a separation in point of time. The second will become more pressing as the first is solved. As armament plants and equipment are completed, and existing industries are called upon to supply them with parts and materials, it will become possible to determine whether those who say, figuratively, that we should give up butter to have guns are correct, or whether it is truly possible to have both guns and butter through more complete and efficient mobilization of our industrial resources.

Everyone will hope that the challenge, embodied in the need for both guns and butter, will be met; and from the standpoint of raw material supplies, capital and credit, and potential labor force, given adequate training programs and cooperation, the goal is not beyond reach. However, "business as usual" will not get the job done on time. It is only prudent to prepare for priorities and sacrifices and for measures to counter inflationary trends—first, to make the armament program effective, and second because inflationary demands allowed to run unchecked would lead only to disaster.

#### **Excess Reserves and Inflation**

Within the past month discussion of the need for bringing under control the huge and unwieldy excess reserves in the banking structure has received impetus from a frank and significant address by the chairman of the Federal Reserve Board, Mr. Marriner S. Eccles. Speaking before the National Industrial Conference Board at New York, Mr. Eccles gave a comprehensive review of credit and monetary problems in the light of the defense program and laid down a series of proposals which help to clarify the problem of future policies.

On the question of inflation, Mr. Eccles very properly draws a distinction between non-monetary and monetary causes. As to the latter, he sees inflation arising when the means of pay-



ment in the hands of those who will spend it increases more rapidly than the production of goods. This would occur, for example, if after the economic system reaches capacity operation, the creation of money supplies is allowed to go on unchecked. Then the added money supplies, being no longer matched by an equivalent increase in the quantity of goods and services for which payments are made, would tend to expend their influence in driving up prices.

On the other hand, inflation, the Reserve Board chairman points out, can also arise from non-monetary causes, such as when "production in particular fields is interrupted or curtailed, whether from bottlenecks, shortsighted wage and price policies, monopolistic practices by labor or capital, or related causes." In such cases, the cure, as he says, is not less, but more production. Any attempt at monetary action fails to reach the root of the difficulty and merely penalizes the whole economy unnecessarily.

While Mr. Eccles has some cogent remarks to make upon the subject of non-monetary causes of inflation, it is with the monetary aspects of inflation that his address is particularly concerned. And here his central theme is the need for regaining control over excess reserves.

#### **Dangers in Present Reserve Position**

There are, as has been pointed out repeatedly, two principal dangers inherent in the present excessively high total of bank reserves.

First, there is the ever-present possibility of these reserves forming the basis of an uncontrolled expansion of bank credit, with inflationary effects upon prices, wages and costs. While it is true, as Mr. Eccles observes, that so long as these funds have been relatively dormant they have not presented this immediate problem, nevertheless these dangers are increased by the rapid business and credit expansion generated by the defense program.

Secondly, there are the threats to the security and welfare of investors, including the banking system, arising from the constantly diminishing rate of interest and the lifting of bond prices to higher and higher levels. Though an advocate of low interest rates in times of depression as a means of promoting recovery, Mr. Eccles is emphatic in expressing the view that present conditions have gone to extremes. However much opinions may differ as to the effectiveness of cheap money as a business stimulant, there should be little disagreement as to the soundness of his following comments:

No such oversupply of excess reserves (as now exists) is necessary to carry out a policy of monetary encouragement to business recovery. Instead, excessively low interest rates tend ultimately to induce inflated prices of Governments, municipals, and other high-grade securities. The effects are reflected in credit lines generally, and are felt by insurance com-

panies, savings banks, educational institutions, and other fiduciaries representing the accumulations of many millions of our people, small as well as large savers. Moreover, this creates a future problem for monetary authorities because at such time as it may become necessary to curtail further credit expansion, as a safeguard against inflationary developments, this step cannot be taken without causing a decline in the price of outstanding securities.

#### **How Control Reserves?**

As an integral part of a program for dealing with this situation, Chairman Eccles urges giving the Reserve System further power to control reserves. The principal measure for accomplishing this would be an increase in member bank reserve requirements to a point which would reduce excess reserves to an amount that could be absorbed by the sale of government securities from the Reserve System's portfolio, leaving only enough securities to take care of the System expenses.

Recently excess reserves reached a peak close to \$7,000,000,000, and though temporarily reduced by December Treasury operations and seasonal currency requirements, are likely soon to regain that level, and probably exceed it. Reserve Bank holdings of Government securities, on the other hand, total only about \$2,200,000,000, and probably could not be reduced below \$1,000,000,000 to \$1,500,000,000 without seriously impairing the earning power of the System.

At present the Reserve System has powers to raise reserve requirements sufficient, if utilized, to eliminate approximately \$1,000,000,000 of excess funds. If reserve requirements should be raised gradually over a period to a maximum of, say, 50 per cent above the present legal limit, excess reserves would be reduced to less than \$2,000,000,000, which is a sum that might be expected to be absorbed in a reasonable period by currency and deposit expansion.

In addition, Mr. Eccles suggested that reserve requirements be made applicable to all banks of deposit, whether they be members of the Federal Reserve System or not. Furthermore, possibly as an inducement to non-member banks, Mr. Eccles suggested that deposits held with the Federal Reserve Banks and in the form of vault cash be exempted from assessment for Federal deposit insurance.

In order for these steps to be effective, Mr. Eccles recognized the need for dealing with gold in a manner to prevent future acquisitions from adding to excess reserves, but did not specify just how this should be done. He also proposed the repeal of legislation authorizing purchases of foreign silver, the cancelling of silver seigniorage which could be used for issuance of additional silver certificates, and the repeal of authority under the so-called Thomas Amendment to issue \$3,000,000,000 of greenbacks — all of which procedures or powers are either actively operating to build up excess reserves or carry a threat to do so in the future.

### Some Factors To Be Considered

With much of the foregoing program, there would seem to be little reasonable basis for difference of opinion. Certainly the silver program has been a failure, which has proved costly to the Treasury and added to the problems created by surplus funds. While the authority to issue \$3,000,000,000 greenbacks has never been utilized, its existence on the statute books is a disturbing element in the background.

The proposals as to member bank reserve requirements are sound as to the major objective—the recapture of control of the money market. The precise character and timing of steps to reach this objective call, of course, for careful study of all possible consequences. Presumably any legislation that might be adopted would place upon the supervising authorities the responsibility for basing their action on just this sort of study; and it may be fairly assumed that any action would be gradual over a period, without drastic moves that might give a shock to the bond market or impede Treasury financing.

In any action upon reserve requirements for example, it is particularly important to take account of the location of excess reserves. The following table gives the latest available figures on the distribution of excess reserves, as reported in the Federal Reserve Bulletin:

Daily Average, Oct. 1940—Millions of Dollars	Reserves With Federal Reserve Banks			
	Total	Required	Excess	% Excess
Total .....	14,043	7,179	6,864	95.6
New York City..	6,889	3,424	3,465	101.2
Chicago .....	1,279	669	610	91.2
Reserve Cities....	4,024	2,136	1,888	88.4
Country Banks..	1,851	949	902	95.0

On the surface, it would appear that about half the excess reserves belong to New York City banks. While this is true as to the location of these reserves, it is not true as to their ultimate ownership and control. A reference to the figures of domestic inter-bank deposits reported by the New York City banks will show that the amounts due other banks—chiefly out-of-town institutions—foot up to approximately \$3,800,000,000, or more than the total excess reserves accredited to New York. In other words, New York City banks have little or no excess funds over and above the sums deposited here by out-of-town correspondents, some of which of course is a normal working balance. Much the same conditions exist in Chicago. Actually, therefore, a major part of the excess reserves is owned by the banks in the smaller cities and towns.

### Effectiveness of Monetary Controls Under Present Conditions

No doubt some questions will arise in the minds of readers as to how far monetary measures, such as curtailment of excess reserves,

can be counted on to restrain inflationary tendencies under present conditions. With the pressing need for larger and larger production to carry on the defense program, and with the prospect of billions of dollars of new Treasury securities to be sold, what chance would there be of applying credit controls with sufficient vigor to check determined speculative movements or a strong rise of prices?

Obviously the use of credit control measures has limitations at this time. So long as the war emergency lasts, we shall probably have to rely primarily upon other means for keeping inflation in check. This, however, does not dispose of the argument for doing something about excess reserves. If the total of these funds could be reduced to more reasonable levels the result would be beneficial in three principal ways, (1) it would relieve the pressure upon interest rates which is causing such great difficulties to investors and savers of all kinds, (2) it would aid the Treasury in placing a larger proportion of its securities with the public, and (3) it would tend to moderate the expansion of bank credit. To the extent that expansion of bank credit and creation of new deposits are avoided, the quantity of inflationary material lying about will be reduced.

Mr. Eccles is evidently fully aware of the limitations upon credit measures under present conditions. As head of the Federal Reserve Board, he is naturally most concerned with the money market, nevertheless he points out many of the other factors entering into the problem of inflation. Among these the most potent at the moment are undoubtedly in the realm of fiscal policy, including the amount and kinds of taxes, the size of the government deficit and the manner in which it is financed, whether from the investment of savings or by borrowing from the banks.

It is gratifying to find these important questions receiving serious consideration. For the success of the defense program depends not alone upon production but also upon maintaining financial and economic stability. Getting our credit and financial mechanism under proper control is a part of this task.

### Shipping Losses and Our Shipbuilding Program

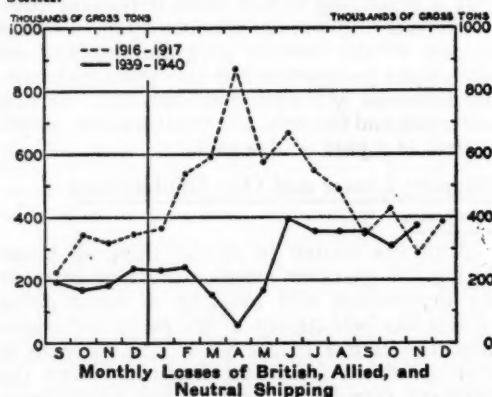
With the stepup in Allied shipping losses during the past few months, the race between the destruction and building of ocean-going vessels has become one of the major influences upon the course of the war. The increase in sinkings dates from last Summer when the Germans established bomber and naval bases on the Atlantic. So considerable have been the losses since that, if continued, they will create a shipping situation comparable to that of 1917. They have led already to stricter rationing of

foods and other goods in Great Britain, and have also contributed to the rise in prices since mid-Summer of many commodities imported by this country, including rubber, cocoa, wool, pepper and tropical oils. Freight rate increases to the Far East and Africa have been slight in comparison with those during the first World War, and the Maritime Commission has given assurance that adequate tonnage will be furnished for American import requirements. Tonnage available for general charter, however, is substantially less than the demand; and the increase in sinkings makes buyers fearful that the situation will tighten steadily.

During the first nine months of the war, the average weekly loss of British, Allied and neutral shipping was about 40,000 tons, representing a rate of about 2,000,000 tons per year. The Allies more than offset the loss in that period by new construction, by capturing about one-tenth of the German merchant marine, and by buying or chartering vessels of neutral countries. Since the beginning of June, however, the average weekly rate of loss has risen to nearly 100,000 tons, equivalent to about 5,000,000 tons per year.

Total losses to the world mercantile marine, including Italian and German, amounted in the first sixteen months of the war to fully 4,500,000 tons. Despite new building and recommissioning of old ships, these sinkings, and the driving of most of the German and Italian merchant fleets from the high seas, have reduced the world effective shipping capacity, which aggregated about 68,000,000 tons in June 1939, by possibly 10 per cent.

As will be seen from the accompanying chart, the recent rate of loss is still considerably below the record level which lasted for a comparatively few months in 1917. The figures do not include damaged tonnage, which in the first World War was as large as the tonnage sunk.



#### Shipping Capacity at Disposal of the Allies

Following the German occupation of the Continent, the British Ministry of Shipping

assembled the largest merchant fleet ever operated under one management. In addition to all seagoing British ships, this fleet included Norwegian, Dutch, Belgian and Polish shipping, a few Danish vessels seized temporarily for the service of the Allies, and some French tonnage now plying under French and British flags,—altogether, it is reported, almost 30,000,000 tons or 45 per cent of the entire world merchant tonnage. As a result, the shipping capacity at the disposal of the British last Summer was about 8,000,000 tons larger than when the war started. The net addition, of course was smaller, since some of the tonnage acquired had been previously operated under charter; moreover, with the blockaded coastline extended some 2,000 miles from the North Cape to the Pyrenees, and the French Navy withdrawn, some of the most efficient merchant ships had to be assigned to naval service.

Since last Summer the Allied tonnage has been increased further by the addition of the bulk of the Greek merchant marine, about 1,500,000 tons. The supply of ships available for charter in the open market has now almost disappeared, except for a few relatively unimportant tramp fleets. With Swedish, Finnish and Russian space limited to the carrying of their own trade, American ships excluded from the war zone, and the Japanese fleet also avoiding European waters, all but a small fraction of the world merchant tonnage is subject to some form of restriction.

#### Low Efficiency of Shipping in War

While the actual tonnage of the far-flung fleet directed from the Ministry of Shipping in Berkeley Square, London, has thus increased, the effective carrying capacity of the vessels has been greatly reduced. Repeated bombing of England has impaired the usefulness of certain ports, especially along the southeastern coast. Waiting for convoys to assemble, slow travel in convoys, and the lengthening of the average voyage per vessel have lowered efficiency. Perhaps 30 per cent of British imports, which up to last June were carried only the short distance from Continental Europe, now have to be drawn from much farther away. The British war effort is increasingly dependent upon overseas support, particularly from North America. The short route from the Far East through the Suez Canal and Mediterranean Sea has been closed. Meat and dairy products, which formerly were imported from nearby Denmark and the Netherlands, now must be brought in part from New Zealand or Australia around the Cape of Good Hope on a trip lasting up to three months. Much of the timber and wood pulp, formerly carried from Scandinavian ports, now comes from the Pacific ports of Canada.



Fighting the attack upon their ocean lanes of supply, the British are strictly rationing cargo space. Importation of bulky or less important consumption goods, such as fresh fruit, has been restricted. Record freight cargoes are being loaded and reports have been heard of luxury passenger liners sailing with their cabins and dining salons packed to the ceiling with needed goods. Australia, instead of shipping fresh eggs, will in future send them in dry form to make more room for war material and other essentials. Some of the shipping routes have been reorganized; for example, British boats in the West African-United States cocoa trade, instead of making the run directly between the two countries, are being required to carry cargoes from here to the United Kingdom before proceeding to West Africa.

As shipping losses have become more serious, freight rates and charter rates have risen further, and the market price of old ships, as recorded in the *London Shipping World*, is now about 55 per cent higher than before the outbreak of war. As for new construction, the low-cost European yards are shut off, and United States costs are much higher. Some types of vessels cost several times as much here as they would have cost in Europe.

#### Difficulties of Allied Shipbuilding

Whether the problem of shipping supply for the Allies has yet become critical is largely a matter of definition. Unquestionably it may become so. The capacity of British shipyards has remained substantially behind the current rate of shipping losses, the growing volume of repair work, and the increasing requirements of the Navy. There is reported to be still some reserve tonnage, including Allied vessels operating on neutral trade routes from this country. The British Ministry of Shipping, however, has declared that the time has come to secure, as a safety margin, additional old and new tonnage from overseas.

The assistance that the Empire countries can render is no doubt greater than during the first World War, but as a whole it is still limited. According to a survey by the *London Economist*, the Australian shipbuilding industry lacks auxiliary industries, such as marine engineering. The Canadian shipyards, which launched almost 300,000 tons of shipping in 1919, for the most part are outfitted to build small vessels. Steps have been taken to expand the shipyards in British India, but it will take time before these become important.

#### Greater Employment of Our Merchant Marine

Hence, to make up their current losses, the British will have to rely to an increasing extent upon our existing tonnage and upon a share in our new ship production, as they did during the first World War. Purchases made in this market to date have been chiefly old-fashioned

and low-cost cargo vessels, including many vessels that had been laid up. The Allies have now acquired a majority of the 188 American ocean-going vessels (over 2,000 tons) transferred to foreign registry or sold since the outbreak of the war.

As will be seen from the table below, the number of our laid-up ships, including those owned by the Maritime Commission, was reduced from 306 on July 1, 1939 to 198 by October 1, 1940. Undoubtedly there has been a further decline since that date, and it is unlikely that any vessels capable of immediate use are still laid up.

Employment of U. S. Ocean-Going Merchant Vessels (Steam and Motor Vessels of 1,000 Gross Tons and Over)

Date	Employed in Foreign Trade		Employed in Coastwise Trade		Laid Up	
	Vessels	Tonnage (000)	Vessels	Tonnage (000)	Vessels	Tonnage (000)
July 1, 1938..	366	2,392	694	3,785	362	2,019
July 1, 1939..	319	2,094	773	4,304	306	1,736
Oct. 1, 1939..	340	2,255	799	4,471	263	1,451
Jan. 1, 1940..	327	2,103	761	4,488	230	1,361
Apr. 1, 1940..	386	2,407	746	4,245	218	1,217
July 1, 1940..	426	2,696	693	3,907	131	1,045
Oct. 1, 1940..	379	2,417	699	4,024	198	1,110

In some instances, our own shipping also has had to draw upon laid-up tonnage to make up, temporarily at least, for vessels transferred to our naval auxiliary services. Moreover, the employment of our ocean-going merchant marine is larger now than at the outbreak of war, despite reduction of our tanker service by the closing of the Mediterranean. Some 115 vessels withdrawn from the European trade have been shifted to other trade routes, chiefly to Latin America and the Far East. As shown in the table, our total tonnage engaged in foreign trade on October 1, 1940 was 15 per cent higher than on July 1, 1939. It has been estimated that about 40 per cent of our foreign trade is now carried by American ships, compared with an average of 29 per cent in the years 1933-38. Over 50 per cent of our rubber imports are arriving in American ships, compared with only 15 per cent prior to the war.

An important factor contributing to the employment of our merchant marine has been the accumulation of stock piles of strategic raw materials under our national defense program. Imports of tin and rubber have set new high records in the last few months, adding approximately a half-year's reserve to the stocks in this country.

#### The Merchant Fleet and Defense Requirements

While many over-age and laid-up American ships have been sold, our long-range program for the replacement of older ships by modern vessels has been retarded but little by increasing naval requirements in connection with our two-ocean navy program. The U. S. Maritime Commission planned to build ocean-going ships at the rate of 50 per year for ten years, and in

less than three years contracts have been awarded for 179 vessels.

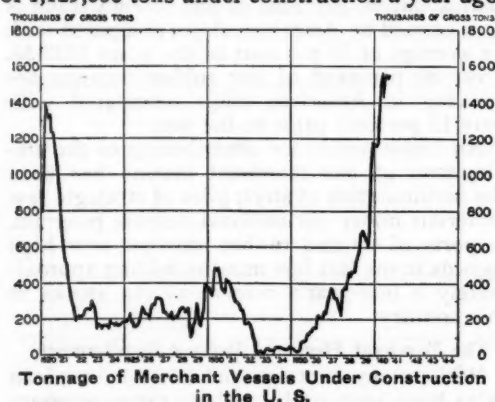
During the first eleven months of 1940 the total tonnage of 46 new U. S. ships completed was 332,000 tons compared with an annual average of 117,000 tons in the 1930-39 period. In 1940, the Navy, in addition to the tonnage acquired from private owners, took over or earmarked nearly one-half of the Commission's merchant ship construction. Among the 53 vessels which were or will be acquired by the Navy are 12 large tankers, capable of a speed of 19 knots. Rear Admiral Emory S. Land, chairman of the Maritime Commission, stated in a recent speech that:

These tankers will carry a total of more than 72,000,000 gallons of oil at a speed which will enable them to keep up with the battle fleet. Using battleship fuel consumption as a basis, those tankers will enable vessels of our fighting fleet to steam a total of more than 800,000 nautical miles without putting in at a naval base.

Under the present naval expansion program, the merchant vessels converted into naval auxiliaries are not intended to be returned to commercial uses, and will have to be replaced.

#### Shipbuilding at Capacity

With the supply of over-age ships now substantially reduced, the British needs for merchant tonnage will have to be satisfied to an increasing extent by new ships. Because of the Maritime Commission's modernization program and the two-ocean navy building, our shipyards are already crowded with the largest volume of construction since the first World War days. As of December 1, 1940, there were under construction a total of 183 ocean-going merchant vessels (over 2,000 tons), aggregating 1,530,000 tons, compared with 139 vessels of 1,129,000 tons under construction a year ago.



Under these circumstances, we can aid Great Britain either by allowing her to share in our present output of new ships or by expanding our shipbuilding capacity or both. Our new tonnage—modern, efficient and built almost exclusively to the specifications of the Navy—is

high in cost, and although cost may be no object to the British, over-age ships can serve under the convoy system. Shipping circles believe that the wiser course would be to speed up the building of new vessels for our own requirements, and to release old vessels for the British as fast as possible. The Maritime Commission in cooperation with shipbuilders has been able to effect substantial savings in the time required for construction, and the most recent ship delivered left the ways less than six months after the keel was laid.

For the expansion of shipyard capacity, the few remaining partially dismantled ways could be reconditioned, and additional ways could be constructed. Such expansion would probably be less costly than the establishment of new shipyards. Moreover, if carefully planned, additional ways can be prepared within two to four months, while totally new shipyards would require longer. According to the National Council of American Shipbuilders the annual capacity of 83 active ways in this country as of January 1940, was about 2 ships per way or no less than 166 vessels, totaling more than 1,000,000 gross tons of average merchant ships. New ways have been added during 1940 and old ones reconditioned. Moreover, as a result of the speed-up and improved methods probably from  $2\frac{1}{2}$  to 3 ships can be built per way annually.

Since our aid to Great Britain may depend ultimately upon the speed with which cargo ships can be launched here, the necessity for mass production of simple stock cargo vessels of medium tonnage for British account is being given careful consideration. Last month the British Purchasing Commission placed the first contract with the Todd Shipyards Corporation for 60 cargo ships of uniform design of approximately 10,000 tons each to be built in the company's new shipyards at South Portland, Maine and Richmond, California. The yards will have 10 ways each and are to be complete in about four months. With keels being laid down before the shipyards are completed, the first ship is expected to be commissioned in October 1941.

Obviously shipbuilding can be speeded up greatly when cost is no object, but time is pressing. New construction from American shipyards cannot be expected to be placed in service in volume before the crucial Spring of 1942, according to Ronald H. Cross, Minister of Shipping. Meanwhile, said Mr. Cross, Britain's shipping problem will become most acute during 1941 and she must look to the United States for tonnage replenishments. Our own needs are also likely to increase in view of heavy requirements for a number of imported raw materials, essential to the defense program and to the industries whose activity is expanding.



## Public Debt in the United States

The growth of public debt in this country, and the amount and distribution of the additional large borrowing that is expected for financing the national defense program, are manifestly questions of great importance, upon which our inquiries indicate that more and more people are seeking accurate data. Last month the federal debt reached practically \$45,000,000,000—the former statutory limit—after an issue of \$531,000,000 in 5-year  $\frac{3}{4}$  of one per cent defense notes was sold. In the revenue act passed last June, the Treasury was given authority to issue \$4,000,000,000 of special defense obligations up to five years maturity. It was provided that the collections from the defense super-tax, which has been added to ordinary federal taxes for a period of five years, should be earmarked for retirement of the defense obligations. The Treasury has since proposed that these restrictions be removed, and that the present debt limit of \$49,000,000,000 be raised to \$60,000,000,000 or \$65,000,000,000 for all purposes.

The end of December 1940 also marked the tenth anniversary of the post-war low point of federal debt, which stood at \$16,026,000,000 on December 31, 1930. The fact that ten years has now elapsed since federal expenditures have been covered by receipts, despite successive increases in tax rates and receipts to the highest level ever reached, should be a cause for serious consideration by every citizen in the United States. The interest charge alone for the current fiscal year was estimated in the last budget at \$1,100,000,000—a figure which is half again as large as total government expenditures for all purposes before the World War. Unfortunately, however, relatively few people have any familiarity with governmental finances or any conscious interest in the subject. Moreover, the present scope and complexity of the federal debt and budget, and the absence of any long-term fiscal policy, have left even business and financial experts in the dark as to how much further the debt is likely to rise during the next few years.

### Composition of the Federal Debt

A condensed summary of the composition of the direct federal debt based upon figures available at this writing—just before it crossed \$45,000,000,000—is given herewith.

Treasury bonds outstanding include maturities ranging from 1941 (with \$545,000,000 in  $3\frac{3}{8}$ s called for redemption on March 15 and \$834,000,000 in  $3\frac{3}{8}$ s maturing on August 1) to 1965, and carry interest rates of from 2 to 4 $\frac{1}{2}$  per cent. Total bonds now make up approximately 71 per cent of the gross debt, compared with only 48 per cent five years ago. The upward trend in the proportion of long-term debt, and the corresponding decrease in short-term,

### Federal Government Direct Debt—December 23, 1940 (In Millions of Dollars)

Issues	Amount	%
Treasury bonds (a) .....	\$28,154	62.7
U. S. savings bonds .....	3,169	7.0
Adjusted service bonds (b) .....	760	1.7
<b>Total bonds .....</b>	<b>32,073</b>	<b>71.4</b>
Treasury notes .....	6,181	13.7
Treasury bills .....	1,317	2.9
Special issues (c) .....	4,863	10.8
<b>Total int. bearing debt .....</b>	<b>44,434</b>	<b>98.8</b>
Matured debt .....	187	0.4
Debt bearing no interest .....	378	0.8
<b>Total gross debt (d) .....</b>	<b>\$44,999</b>	<b>100.0</b>

(a) Includes old issues of Panama Canal and conversion bonds; also postal savings bonds. (b) Includes bonus bonds held by veterans, and a special issue to government life insurance fund. (c) Includes direct note issues to social security and other trust funds; also includes certificates of indebtedness. (d) Direct debt only; does not include guaranteed debt of government agencies.

has reduced the number of issues to be refunded during the next few years and helped the Treasury to "clear the decks" for the forthcoming defense loans.

Treasury notes outstanding include maturities up to five years and carry interest rates of from  $\frac{3}{4}$  to 2 per cent. Treasury bills consist of issues maturing weekly in amounts of approximately \$100,000,000 and represent yields when sold on a discount basis for 91 days ranging from 0.004 per cent per annum to a "negative yield" (i.e., some subscribers, for reasons connected with taxation, offered over par for the non-interest bearing bills).

"Special issues" are those placed with social security, government employees' retirement, government life insurance, postal savings and other trust funds and agencies, some of which hold "general issues" as well. "Matured debt," as the title implies, represents various issues matured or called for redemption, but not yet turned in for payment. "Debt bearing no interest" comprises principally the net liability on United States notes (greenbacks) outstanding, and on the old national bank notes and Federal Reserve Bank notes, the issuance of which was discontinued several years ago and for which the Treasury then took over the liability.

Practically all of the outstanding government debt is represented by what are termed "general obligations". These are not a specific lien upon the gold reserve or other assets held in the Treasury, but are secured by the taxing power of the Government upon the business transactions and income of corporations and of individuals throughout the country. The gold reserve of \$22,000,000,000 is already pledged to the extent of \$20,000,000,000 by the issuance of gold certificates or credits to the Federal Reserve Banks, which hold the certificates as reserve against Federal Reserve notes out-

standing and against their deposits, which in turn represent the reserve of member banks for their own deposits. The Treasury's monetary gold stock, therefore, constitutes the backing for the country's currency and bank deposits, and the relationship between the gold reserve and the national debt has no close significance. Only about \$2,000,000,000 of the gold is unpledged and available for payment of debt.

#### Government Agency Debt

Obligations of government agencies, not included in the above figures of direct federal debt, totaled \$9,167,000,000 on October 31, 1940 and were offset by the loans and investments, cash, real estate and other assets held by the agencies and totaling \$13,159,000,000 book value.

Agency obligations fully guaranteed by the Treasury amounted to \$5,851,000,000 and included \$2,642,000,000 for the Home Owners' Loan Corporation, \$1,285,000,000 for Federal Farm Mortgage Corporation, \$1,100,000,000 for Reconstruction Finance Corporation, \$698,000,000 for Commodity Credit Corporation and \$115,000,000 for U. S. Housing Authority.

Agency direct obligations do not include the outstanding guarantees of such agencies as the Federal Deposit Insurance Corporation on bank deposits, Federal Savings & Loan Insurance Corporation on savings and loan certificates, and Federal Housing Administration on home mortgage and improvement loans. Such contingent liabilities are not guaranteed by the Government, but are backed by the assets of the respective agencies.

#### Distribution of the Federal Debt

Holdings of federal debt by the banks, insurance companies and government agencies accounted for 75 per cent of the total outstanding on June 30, 1940. Following is a compilation of the principal known holders as of this, or the latest available date, and ten years before, including both direct and fully guaranteed debt, which for certain groups is not reported separately:

Distribution of U. S. Government Direct and Guaranteed Debt As of June 30, 1930-1940 (In Millions of Dollars)			
Outstanding	June 30, 1930	June 30, 1940	Change
Total direct debt .....	\$16,185	\$42,968	+26,783
Total guaranteed debt.....	.....	5,560	+ 5,560
Total debt .....	16,185	48,528	+32,343
<b>Distribution</b>			
<b>Banks</b>			
Commercial banks—direct....	4,796	13,089	+ 8,293
Commercial banks—guarantd.	.....	3,460	+ 3,460
Commercial banks—total..	4,796	16,549	+11,753
Mutual savs. & priv. bks. (a)	702*	3,162	+ 2,460
Total banks, excl. F.R.B.....	5,498	19,711	+14,213
Federal Reserve Banks.....	591	2,450	+ 1,859

#### U. S. agencies & trust funds

Old-age insurance fund .....	1,738	+ 1,738
Railroad retirement account .....	79	+ 79
Unemployment comp. tr. fd. ....	1,710	+ 1,710
Govt. empl. retirement funds .....	158	+ 410
Veterans' ins. & trust funds .....	704	+ 154
Postal savings system .....	26	+ 1,192
Federal Deposit Ins. Corp.....	.....	+ 347
Fed. Svgs. & Loan Ins. Corp. ....	123	+ 123
Other government agencies .....	30	+ 379
Other trust funds .....	58	+ 35

Total agencies & tr. funds 976 7,073 + 6,097

#### Insurance companies

Life insurance companies....	331*	6,088*	+ 5,757
Fire insurance companies....	169*	462*	+ 293
Casualty insurance companies .....	108*	470*	+ 362

Total ins. companies..... 608 7,020 + 6,412

Total accounted for ..... 7,673 36,254 +28,581

Balance unaccounted for,  
held by individuals, cor-  
porations, trustees, etc. ....

8,512 12,274 + 3,762

#### Percentage distribution:

Commercial banks .....	29.7	34.1	+ 4.4
Savings & private banks .....	4.3	6.5	+ 2.2

Total banks .....	34.0	40.6	+ 6.6
Federal Reserve Banks....	3.6	5.0	+ 1.4
U.S. agencies & tr. funds .....	6.1	14.6	+ 8.5
Insurance companies .....	3.8	14.5	+ 10.7

Total accounted for..... 47.5 74.7 + 27.2

Balance unaccounted for.. 52.5 25.3 — 27.2

\*Partly estimated. (a) Private bank holdings amounted to \$2 millions in 1930 and to \$49 millions in 1940.

It will be seen that during the ten-year period, 1930-1940, the total direct debt increased by over \$26,000,000,000, in addition to which over \$5,000,000,000 of guaranteed debt was created, making a total increase of over \$32,000,000,000.

Of this increase, something over \$8,000,000,000 of the direct debt and \$3,000,000,000 of the guaranteed debt was taken by the commercial banks. Mutual savings banks increased their holdings by over \$2,000,000,000, and the Federal Reserve Banks by \$1,859,000,000.

Government trust funds, including the old-age insurance, unemployment compensation, civil service and veterans' funds, together with the postal savings system, the Federal Deposit Insurance Corporation and other government agencies, absorbed more than \$6,000,000,000 of government securities during this period. Life, fire and casualty insurance companies also purchased more than \$6,000,000,000 net. Thus the aggregate purchases of new debt accounted for by the known institutional holders and trust funds was \$28,000,000,000, or nine-tenths of the total increase.

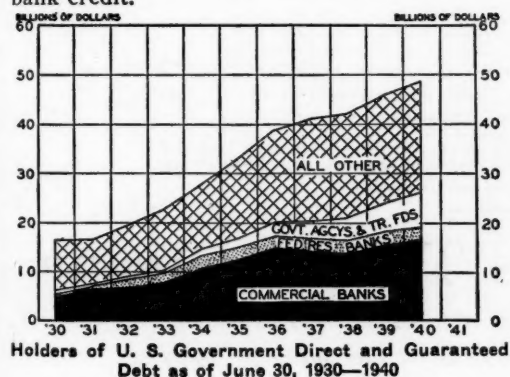
#### Commercial Bank Holdings

Commercial banks absorbed about one-third of the new federal public debt created during the period. Four-fifths of the total increase in their holdings took place in the first six years, which was a time when secured and commer-

cial loans of the banks were declining rapidly. Another factor in the increase in government security holdings by the banks was the calling for redemption of certain Liberty and Victory Loan issues, which were widely held by investors, and their refunding into short-term and low-coupon issues that appealed principally to banks.

Contrary to a common opinion, only a comparatively small part of the increase in public debt during the past four years has been taken by the commercial banks, involving an expansion of bank deposits and carrying inflationary dangers. This is shown on the accompanying chart. The major portion of new debt has been absorbed by the social security and other trust funds, the savings banks, insurance companies and other investors, whose purchases come out of savings and involve no increase in bank deposits.

Considering the banking system as a whole, the holdings of guaranteed obligations to considerable extent represent an exchange for farm mortgage, urban mortgage and other types of loans previously held and refinanced by the government agencies set up at that time, and therefore do not involve net increases in bank credit.



#### Maturities of Bank Holdings

Over 40 per cent of the total government portfolio of the commercial banks, according to latest figures, consists of bills, notes and bonds maturing in less than five years. On June 30, 1940, the government direct and guaranteed issues held by all banks which were members of the Federal Deposit Insurance Corporation, and whose holdings comprised 96 per cent of the total for all commercial banks, were distributed by maturities as shown on the table.

These figures reflect the wide extent to which commercial banks have followed a policy of keeping a large portion of their rapidly increasing deposits in cash and in short-term government securities, which afford extremely

#### Maturity Distribution of U. S. Government Security Holdings by All Insured Banks—June 30, 1940 (In Millions of Dollars)

Under five years	Amount	Per Cent
Treasury bills .....	\$ 805	5.1
Treasury notes .....	2,699	17.0
Treasury bonds—under 5 years.....	750	4.7
Guaranteed—under 5 years .....	2,158	13.5
Total under five years .....	6,413	40.3
Over five years		
Treasury bonds—5 to 10 years.....	3,489	22.0
Treasury bonds—10 to 20 years.....	4,110	25.8
Treasury bonds—over 20 years.....	677	4.3
Guaranteed—over 5 years .....	1,212	7.6
Total over five years .....	9,488	59.7
Grand total .....	\$15,901	100.0

small yields and reduce current income correspondingly, but which would be subject to relatively small decline in market price in the event of a tightening of interest rates and a readjustment of the bond market to a higher yield basis. Government security holdings of banks will be accepted by the Federal Reserve Banks at par as security for advances.

Moreover, the prices at which government bonds are carried on the books of most banks are probably well under the prevailing market values, giving a "cushion" represented by unrealized price appreciation and by the application of profits on bonds sold during recent years against various "reserves" rather than to current income.

The aggregate government security holdings of all insured banks given above compare with aggregate capital funds on the same date of \$6,606,000,000, including outstanding capital of \$2,892,000,000, surplus of \$2,484,000,000 and undivided profits of \$837,000,000.

#### State and Local Government Debt

In discussions of the question of public debt, attention is usually centered upon the growth of the federal direct and guaranteed debt, while the heavy outstanding indebtedness of state, county, municipal and special district (school, highway, sewer, drainage, etc.) governments is given but slight consideration. These local governments, however, number approximately 175,000, and have the authority to spend, to tax and to borrow more or less independently. A recent survey showed that their outstanding indebtedness at the end of 1939 aggregated \$19,626,000,000.

The further large increase in federal debt for financing the defense program shows the opportunity and need for complete cooperation between all the overlapping government units in this country, in order that local expenditures may be held down and local debt reduced from its present burdensome level as partial offset to rising federal debt.



# The National City Bank of New York

Head Office • 55 WALL STREET • New York

## Condensed Statement of Condition as of December 31, 1940

INCLUDING DOMESTIC AND FOREIGN BRANCHES

### ASSETS

Cash and Due from Banks and Bankers.....	\$1,364,824,538.41
Gold Abroad or in Transit.....	1,401,172.26
United States Government Obligations (Direct or Fully Guaranteed).....	860,973,665.95
Obligations of Other Federal Agencies.....	40,806,921.95
State and Municipal Securities.....	148,105,462.26
Other Securities.....	67,313,993.14
Loans, Discounts and Bankers' Acceptances.....	544,312,304.95
Real Estate Loans and Securities.....	7,363,079.66
Customers' Liability for Acceptances.....	7,043,465.84
Stock in Federal Reserve Bank.....	3,915,000.00
Ownership of International Banking Corporation.....	7,000,000.00
Bank Premises.....	41,224,959.41
Other Real Estate.....	273,324.19
Other Assets.....	908,499.05
<b>Total.....</b>	<b>\$3,095,466,387.07</b>

### LIABILITIES

Deposits.....	\$2,908,437,735.00
Liability on Acceptances and Bills.....	\$15,812,705.56
Less: Own Acceptances in Portfolio.....	6,075,062.89
Items in Transit with Branches.....	9,737,642.67
Reserves for:	
Unearned Discount and Other Unearned Income.....	6,610,912.06
Interest, Taxes, Other Accrued Expenses, etc. ....	3,910,095.66
Dividend.....	5,894,066.64
Capital.....	3,100,000.00
Surplus.....	\$77,500,000.00
Undivided Profits.....	64,500,000.00
<b>Total.....</b>	<b>\$3,095,466,387.07</b>

Figures of Foreign Branches are as of December 23, 1940.  
(London as of December 21)

\$75,007,375.92 of United States Government Obligations and \$35,778,203.09 of other assets are deposited to secure \$87,014,169.33 of Public and Trust Deposits and for other purposes required or permitted by law.

(Member Federal Deposit Insurance Corporation)

# City Bank Farmers Trust Company

Head Office • 22 WILLIAM STREET • New York

## Condensed Statement of Condition as of December 31, 1940

### ASSETS

Cash and Due from Banks.....	\$ 46,340,438.03
United States Government Obligations (Direct or Fully Guaranteed).....	37,357,300.04
Obligations of Other Federal Agencies.....	3,019,473.83
State and Municipal Securities.....	9,869,483.55
Other Securities.....	1,848,841.61
Loans and Advances.....	6,150,593.11
Real Estate Loans and Securities.....	5,851,931.91
Stock in Federal Reserve Bank.....	600,000.00
Bank Premises.....	3,901,196.25
Other Real Estate.....	372,615.78
Other Assets.....	1,578,239.38
<b>Total.....</b>	<b>\$116,890,113.49</b>

### LIABILITIES

Deposits.....	\$ 90,188,331.45
Reserves.....	1,577,386.76
Capital.....	10,000,000.00
Surplus.....	10,000,000.00
Undivided Profits.....	5,124,393.28
<b>Total.....</b>	<b>\$116,890,113.49</b>

\$1,583,363.41 of United States Government Obligations are deposited with public authorities for purposes required or permitted by law.

(Member Federal Deposit Insurance Corporation)

